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C O N F I D E N T I A L SECTION 01 OF 03 LAGOS 000740

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TAGS: EPET ENRG PGOV NI
SUBJECT: RESOURCE NATIONALISM IN NIGERIA

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Classified By: Acting Consul General Vicki Hutchinson for reasons 1.4 (
B) and (D)

This is a joint Embassy Abuja and Consulate General Lagos
response to Reftel A.

¶1. (C) Summary: Resource nationalism is not a significant movement in Nigeria. GON officials publicly and privately express a desire to attract more foreign investment in the petroleum sector. However, tough new local content requirements are in practice nationalistic and could hamper petroleum sector development. Increasing regulatory capacity building programs and strengthening bilateral trade and investment arrangements could help Nigeria efficiently develop its resources. End Summary.

Nationalism in Nigeria's Discourse

¶2. (C) The political and economic discourse in Nigeria is not overtly nationalistic. Politics in Nigeria are a complicated mix of ethnic, regional, and religious loyalties, fueled by money funneled through a patronage system. Populist resource nationalism is not a significant part of that equation. While international oil companies (IOCs) are a frequent target of criticism in the press and a convenient whipping boy for politicians, there is no real move to follow the example of Bolivia or Venezuela. (Note: Oil and natural gas are the only significant extractive industries in Nigeria at present, though mining has potential. End Note.)

¶3. (C) Even in poverty stricken oil states, attempts to extract more money from IOCs take the form of demands for increased use of locals to supply equipment, labor, or "security" to oil installations or for various local assistance projects. Nigeria's national oil company, Nigerian National Petroleum Corporation (NNPC) and small indigenous oil companies face the same demands, evidence that these are opportunistic attempts by local leaders to cash in on oil company operations. There is also legitimate criticism that oil proceeds fall prey to corruption rather than being used to create a better future for ordinary Nigerians.

¶4. (C) What is often mistaken for resource nationalism in Nigeria is usually poorly articulated public statements combined with sensationalist press coverage. In a recent example, presidential advisor on energy, Rilwanu Lukman told the press that Nigeria would "reconsider its generous terms" with the IOCs. This vague pronouncement made a splash in the local and international media which reported his statements without follow up or context.

¶5. (C) However, senior presidential advisor on petroleum Dr.
¶O. Emmanuel Egbogah met with Econoffs a week later and clarified those remarks (Reftel B). As reported in Reftel C, the GON announced a future reorganization of its petroleum sector. As part of that reorganization, it plans to restructure onshore oil production joint venture (JV) agreements with the IOCs. These JVs require NNPC to make periodic cash payments to the IOC JV operating partner. The GON has had significant trouble making these payments, much to the chagrin of the IOCs. (Note: GON cash call arrears are routinely cited by IOC executives as one of the most serious business problems they face. End Note.) The GON hopes to bypass this problem by restructuring JVs to attract third party investment and eliminate the need for cash call payments. Lukman's comments were aimed at this, but his failure to elaborate, plus shoddy media reporting, implied a plan to abrogate all GON contracts.

¶7. (C) President Yar'Adua has said that he wants to see a contract structure that will permit greater third party investment in petroleum joint ventures, freeing the GON to use its money on social spending or other infrastructure projects. The head of Nigeria's oil regulator, Tony

Chukwueke, has called for more foreign investment in Nigeria and offered to lead a delegation to the United States to convince small, independent oil companies that Nigeria is a place to invest (Reftel D).

¶8. (C) Nigerian officials do publicly complain about costs associated with production sharing contracts (PSCs), the form of contracts used in Nigeria's deepwater offshore oilfields. The contracts are structured to allow the operator to recover exploration and production costs before sharing oil profits. Nigerian politicians have accused the IOCs of cost padding, such as cost overruns at Shell's Bonga and Exxon Mobil's Erha offshore facilities. There have been threats to investigate these projects and impose tougher PSC terms (Reftel E).

¶9. (C) While Nigeria may not be nationalizing its oil industry in the traditional sense of the word, we expect it to drive a hard bargain in future contract negotiations. Future PSCs will likely include tighter terms on ring fencing and cost recovery write-offs in attempts to reduce the impact that rising project costs have on the timing of GON revenues. We expect the GON will use the entrance of Asian oil companies into West Africa, IOC fears of nationalization, and higher oil prices to extract every advantage in new contracts while not scaring away needed foreign investment.

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Local Content Motivated by Resource Nationalism?
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¶10. (C) GON has not proposed or implemented specific policies directly motivated by resource nationalism. Nonetheless, new legislation requiring local content in petroleum projects could affect the ability of international firms, especially oilfield service firms, to operate profitably in Nigeria. The Local Content Bill will mandate specific and very high levels of Nigerian value added content and employment in most oil and natural gas projects. For example, the bill requires 55 percent of funds spent on well testing services be spent with Nigerian-owned companies and 90 percent of front end engineering and design and 100 percent of all 2D and 3D

seismic services (in man-hours) by performed by Nigerians. The bill is vague in what would legally constitute "Nigerian" content and leaves room for regulators to apply the law capriciously.

¶11. (C) The status of the proposed legislation is murky. It did not pass during the National Assembly's last term, but its sponsor plans to reintroduce it this year. (Note: The House Speaker's corruption scandal and resignation have crippled the National Assembly calendar. End Note.) The IOCs are engaging with legislators and regulators to reduce the bill's most severe clauses, but passage of the legislation itself seems to be a forgone conclusion. Language that mandated criminal penalties and jail time for failure to comply has been dropped.

¶12. (C) International oilfield services companies have also expressed concerns about the bill. They see themselves squeezed out of projects by less capable, but politically-connected local firms. Executives also worry that proprietary technology and techniques will be expropriated by the new law. The oilfield services companies are less organized as a group than the oil majors in Nigeria and, given their relatively smaller size and revenue contribution, wield less influence with Nigerian officials. Nonetheless, they are organizing an industry trade group to lobby the GON, with local content rules as a top priority.

Beneficiaries of Resource Nationalism

¶13. (C) In theory, the local content legislation is driven by a desire to keep oil-related spending localized and increase employment. Contacts point out that a typical foreign oil firm already has a work force that is 85 to 95 percent Nigerian, with expatriate workers limited to highly experienced and senior engineers, technicians, and managers. Use of local firms will likely drive up sector costs and may actually reduce the total number of Nigerians employed.

There are a limited number of Nigerian firms that are capable of performing highly technical oilfield work. Those that are capable are highly sought after. Consequently, oilfield costs are rising and projects are delayed. (Note: On local employment, a Chevron engineering contact reports that a Nigerian firm doing project engineering work actually outsources the project to engineers in India. End Note.)

¶14. (C) The real beneficiaries of the bill will be local oilfield service companies, often owned by politicians, NNPC officials, government regulators, and other Nigerian insiders. Conflict of interest laws are porous, not enforced, and easily evaded. For example, while he was the head of NNPC, former Group Managing Director Funso Kupolokun had financial connections to three petroleum engineering firms that would benefit from increased local content legislation drafted on his watch.

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USG Actions to Address Growing Resource Nationalism
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¶15. (C) Building on country team goals already in place, we recommend a two-prong strategy for confronting potential resource nationalism in Nigeria. First is to promote good governance and regulatory best practices to encourage efficient extraction of petroleum and wise revenue spending. The second is to encourage the GON to diversify its export economy beyond oil by increasing bilateral and multilateral trade ties. A more diverse economy, particularly in the oil-producing Niger Delta, could diminish the perceived need to rely almost exclusively on the petroleum industry for employment and revenues.

¶16. (C) Post already engages with Nigerian regulators and other officials in both areas. We are spearheading a donor group initiative to improve the planning and work of the Nigerian Extractive Industries Transparency Initiative (NEITI). NEITI audits the flow of money from oil producers to the Nigerian government. The work NEITI does will hopefully lead to better use by the GON of oil revenues. We also work closely with electricity regulators at the Nigerian Electricity Regulatory Commission (NERC). The Trade and Development Agency recently launched a study of safety issues for NERC that received much favorable press coverage (Reftel F). USAID/West Africa has a contractor working with officials of the West African Gas Pipeline project (WAGP) on supply, administrative, and business issues.

¶17. (C) With the price of oil over 90 USD per barrel, funding such projects in an OPEC nation may not appear to be a necessary. Nigeria has significant petroleum reserves; it also has an enormous and impoverished population. On a per capita basis, Nigeria has the second lowest reserves in OPEC, even lower than OPEC dropout Ecuador. Revenues from oil are needed to serve the Nigerian population's real and pressing demands. USG assistance on regulatory capacity building programs would be greatly appreciated, widely recognized, and could have a significant impact.

¶18. (C) Post is preparing for Trade and Investment Framework Agreement (TIFA) talks scheduled for 10-11 December (Reftel G). Strengthening TIFA and even moving beyond it towards a Bilateral Investment Treaty would help the GON expand its export economy beyond petroleum, which currently accounts for 99 percent of foreign exchange earnings. A more diversified economy may reduce ill-advised attempts to squeeze more short-term revenues from oil companies to fund social programs.
HUTCHINSON